

NHRS Board of Trustees, Audit Committee
November 13, 2012

NOTE: These minutes from the November 13, 2012 Audit Committee meeting were approved and executed at the December 11, 2012 regular Meeting of the NHRS Audit Committee.

**Audit Committee
Board of Trustees**

The Public Minutes

**New Hampshire Retirement System
54 Regional Drive
Concord, NH 03301**

Committee Members: Catherine Provencher, Chair; Jack Wozmak; Karen McDonough; Dean Crombie.

Staff: George Lagos, Executive Director; Timothy Crutchfield, Esq., Chief Legal Counsel; Jack Dianis, Director of Finance; Larry Johansen, Director of Investments; Nancy Miller, Director of Member Services; Paul Zahensky, Director of Information Technology; Heather Fritzky, Accounting and Financial Reporting Supervisor; John Browne, Internal Auditor. Also in attendance were Dave Gagnon, KPMG Engagement Partner, and Brian Shaughnessy, KPMG Audit Manager.

Upon a request from the Chair, a motion was made by Mr. Wozmak to accept the minutes of the August 14, 2012 meeting. Ms. McDonough seconded the motion, and it carried unanimously.

Mr. Dianis then presenting the unaudited CAFR (Comprehensive Annual Financial Report) as required by RSA 100-A:15. He noted that the core financial statements were presented, with the actuarial opinion, chair's letter, statistical section, etc. soon to be completed. Mr. Dianis said he would be giving a formal presentation of the completed CAFR to the Committee in December.

Next, Chair Provencher requested that Mr. Gagnon present the status of KPMG's 2012 audit. Mr. Gagnon noted there was still work to be done, but referred Committee members to the handout and the draft opinion, saying he expected a clean unqualified opinion on the financial statements. He noted KPMG had reviewed and tested the internal control structure, and concluded there were no significant deficiencies relative to financial reporting. Particular areas of testing included: pricing of marketable securities, contributions and benefit payments, and real estate investment valuations. He did call the Committee's attention to wording changes in the opinion letter for the new Governmental Accounting Standards Board (GASB) requirements relative to management's discussion and analysis and supporting schedules presented to supplement the basic financial statements. Per a question from the Chair, Mr. Gagnon said KPMG would be happy to provide feedback to NHRS in developing a methodology to implement the two new GASB standards for financial reporting of public employee pensions by

state and local governments. Mr. Gagnon also reviewed the topics of required communications with the Audit Committee noting there was nothing out of the ordinary to report.

Mr. Gagnon then presented the Management Letter to the Audit Committee. The first issue dealt with strengthening documentation for the System's ongoing monitoring process to ensure the valuation of alternative investments is appropriately supported. Mr. Johansen spoke to this issue, stating that now that the System has increased its exposure in alternative investments, particularly in private equity, that the investment team is working on creating a more robust document process for these investments taking a two-pronged approach. First addressing the initial due diligence of the alternative investment, and second documenting the review of the monitoring the valuation of the assets. He said the next alternative investment to be presented to the Independent Investment Committee will provide the initial test run for this enhanced documentation of the due diligence process.

Mr. Gagnon then reviewed the second issue relating to real estate investment valuation monitoring, specifically directly-held real estate investments as opposed to fund investments. While he acknowledged these directly-held investments are being sold off, he felt with a value of \$100 million as of June 30, 2012, the process to document the value of these assets by the System's real estate advisors and consultants needed to be strengthened. Mr. Johansen responded by explaining that the Townsend Group, the System's discretionary real estate manager, acts in a fiduciary capacity with the real estate advisors to appropriately value these investments. The plan is to sell three of the remaining seven directly-held properties in the next year. The Chair suggested that the System develop a schedule showing the sales price compared to the valuation price to better document how the process is working. The Committee then had a discussion on how best to document the process of monitoring investments. Executive Director Lagos proposed that internal investment staff come back to the Committee next month to present what is presently being done to address these issues so that all parties have a comfort level with the documentation process.

Mr. Wozmak then raised a question as to whether there had been follow up on KPMG's Management Comments from 2010 concerning Information Technology controls. Mr. Zahensky stated that as outlined in the Audit Tracker, except for Disaster Recovery, he planned on having policies and procedures updated over the next couple of months. Mr. Lagos suggested that he would like to summarize this in an IT update memo to be reviewed with the Audit Committee as there had been a number of changes in this area over the past year.

Mr. Browne then gave an update on the NHRS Audit Issues Tracker. He noted there had been one item on the tracker with an October completion date, and this had been addressed by Mr. Crutchfield and Ms. Miller. It related to the return of employer contributions on the death of an active member within the first 6 months of employment. The Chair asked if any completion dates had been changed. Mr. Browne stated no target dates were adjusted, fourteen items remained outstanding, and he felt items were being addressed appropriately.

Next Mr. Browne reviewed the audit of Active Member Death Benefits. He noted controls over this processing appeared effective. There were a couple of isolated control issues related to procedures involving payments to minors, and benefit payments made on the death of a member

within the first year of employment, but that management was working at addressing them.. The Chair asked that as the System comes across practices that should possibly be revisited in statute, whether these are being recorded for further follow up. Mr. Lagos responded that staff are keeping an inventory of possible statute changes and are prioritizing them for review in the next legislative session.

Mr. Browne then discussed the Employer Account Reconciliation Audit. He explained that the present process was established when PensionGold was implemented approximately nine years ago. The process has created reconciliation issues because it permits employers to submit their contribution reports separately from their checks, and that the present distribution of duties within Employer Services needs to be reorganized. Mr. Browne said that Mr. Lagos has already identified this issue, and has setup a project team to assess processing. Mr. Lagos explained that NHRS is receiving payments timely from employers but that matching payments to contributions reported is a very labor intensive task with many workarounds. He noted there will be changes to the employer reporting process, but first he wants this project team to document and understand the present process before implementing any changes. He also stated that selected staff members will be visiting the Maine Public Employees Retirement System next month to review how t that plan handles employer and member payments to try to identify efficiencies in processing.

Mr. Browne then reviewed the present audit he is working on, which is an evaluation of the monthly annuity payments from Retiree Services. He noted this was another area Mr. Lagos had identified control concerns about, and so as not to duplicate efforts, he is participating on a project team that is reviewing the workflow in Retiree Services. Based on a question from the Chair as to whether this would be a full audit, Mr. Browne explained that he would also be testing transactions and would be issuing a report to the Audit Committee. He noted that based on audit work presently completed, no major exceptions were identified.

Lastly, Mr. Browne provided an update on work he has performed with Member Services and Information Technology to review the process of imaging documents at NHRS. This process has been identified as an issue at NHRS, highlighted in the QDRO audit, and will touch many facets of processing. Mr. Lagos explained this is a big project and while they want to move forward on this, there are presently other projects with higher priorities. He also noted when staff visits the Maine Retirement System, they will review that plan's imaging processing.

There being no further business, the Committee scheduled the next meeting to be prior to the Board meeting on December 11th.

A motion to adjourn was made by Ms. McDonough, seconded by Mr. Crombie, and it carried unanimously.